Supreme Court, U.S.
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No. 96-371

In the
Supreme Court of the United States

OCTOBER TERM, 1996

ERNEST J. CLAYTON ET AL., *Petitioners*

v.

THE UNITED STATES, *Respondent*

On Petition for a Writ Of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR PETITIONERS

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6 pp

TABLE OF CONTENTS

TABLE OF AUTHORITIES i

REPLY 1

CONCLUSION 4

TABLE OF AUTHORITIES

Cases:

Frazer v. Commissioner, 4 T.C. 1152, 1158 (1945), aff'd 157 F.2d 282 (6th Cir. 1946) 1

Lane Processing Trust v. United States, 25 F.3d 662 (8th Cir. 1994) 1

Rowan Companies, Inc. v. United States, 452 U.S. 247 (1981) 2

Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States, 64 F.3d 245 (6th Cir. 1995) 2

Statutes:

I.R.C. § 1 2
I.R.C. § 2(d) 2
I.R.C. § 871(a)(1)(A) 2

Miscellaneous:

I.R.-Mim. 71, 1952-2 C.B. 170 2,3
Rev. Rul. 59-278, 1959-2 C.B. 174 4
Rev. Rul. 70-278, 1970-1 C.B. 281 3
Rev. Rul. 71-478, 1971-2 C.B. 490 3
Rev. Rul. 79-388, 1979-2 C.B. 270 4
Treas. Reg. § 1.72-1(b) 3
Treas. Reg. § 1.401-1(b)(1) 3

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1. The Decisions Below are Contrary to the Decisions of Other Circuits. Respondent's brief erroneously argues that the decisions below do not present a circuit split because this is the first case that involves distribution of "appreciation" from the sale of stock to "foreign employees". (Opp. 10-11.) In fact, at least two of the cases cited in the petition involved the distribution of appreciation realized from the sale of stock. See Frazer v. Commissioner, 4 T.C. 1152, 1158 (1945), aff'd, 157 F.2d 282 (6th Cir. 1946); Lane Processing Trust v. United States, 25 F.3d 662, 663-64 (8th Cir. 1994).

Respondent's assertion that this is the first case to involve a "foreign employee" is only speculation because none of the contrary circuit decisions mentioned the nationality or residence of the affected employees or gave any suggestion that nationality or residence was relevant to deciding whether the distribution to the employee was "compensation" for tax purposes. The Court of Federal Claims did not rely upon the "foreign" status of the petitioners to distinguish its holding from the contrary circuit decisions cited in the petition.[1]

Respondent does not explain why an amount paid to a U.S. employee is "compensation" while the exact same amount paid to a foreign employee is not "compensation". It is true that compensation paid to U.S. residents is taxed at graduated rates, while compensation paid to foreign employees is taxed at a flat rate of 30%. I.R.C. §§ 1, 2(d), 871(a)(1)(A). However, the fact that different Code sections and tax rates apply does not empower the IRS to interpret the statutory term "compensation" to mean one thing for U.S. employees and something else for foreign employee absent compelling evidence that Congress intended the term to have different meanings. Rowan Companies, Inc. v. United States, 452 U.S. 247 (1981).

2. The Decisions Below Misstate the Legislative Reenactment Doctrine. Respondent asserts that the IRS position sustained by the courts below was adopted by the IRS "more than forty years ago" in IR-Mim. 71. (Opp. 7.)

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[1] The Court of Federal Claims declined to consider any contrary circuit decision that preceded the IRS ruling on which its decision was based. (Pet. App. 58a.) One of those decisions could not have been distinguished because it was decided after this case was decided. See Sheet Metal Workers v. United States, supra.

Respondent's citation of IR-Mim. 71 omits to mention that more than *twenty-five* years ago the IRS *revoked* IR-Mim. 71 and declared that it was "not determinative with respect to future transactions". Rev. Rul. 70-278, 1970-1 C.B. 281.

The decisions below are premised on the "presumption" that Congress was aware of and therefore implicitly endorsed those parts of IR-Mim. 71 that were not overruled by exclusions from taxation that Congress enacted in 1960, 1966, and 1980. Yet, if it is to be presumed that Congress was aware of IR-Mim. 71 when it first addressed those issues in 1960 and 1966, it must also be presumed that Congress was aware of its revocation when it finally addressed the same issues in 1980. If Congress's failure to object to IR-Mim. 71 eight years after it was issued constitutes an endorsement of IR-Mim. 71, then Congress's failure to object to revocation of IR-Mim. 71 eight years after it was revoked must constitute an endorsement of the revocation.

Respondent's brief asserts that the 1960, 1966, and 1980 legislative histories "clearly demonstrate" that Congress was aware of and approved IR-Mim. 71. (Opp. 8-9.) In fact the legislative histories *never* mention IR-Mim. 71 and *never* refer to an IRS policy of taxing the earnings component of any distribution from an employees' trust. As explained in the petition (Pet. 11-14), the legislative histories refer only to an IRS practice of taxing "pensions" and "annuities", terms that the IRS itself strictly construes to mean a series of payments made pursuant to an insurance contract or trust arrangement after an employee has retired.[2] It is logical that

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[2] The IRS has defined the terms "pension" and "annuity" by regulation, Treas. Reg. §§ 1.72-1(b), 1.401-1(b)(1), and has construed the terms strictly to exclude other types of distributions to employees, e.g., Pet. at 65a, Rev. Rul. 71-478, 1971-2 C.B. 490.

the legislative history and the Code amendments themselves related only to pensions and annuities because the only relevant rulings that had been issued under the 1954 Code themselves applied only to pensions and annuities.

The first Code amendment (1960) was enacted one year after the first revenue ruling (1959) and the last Code amendment (1980) was enacted one year after the second revenue ruling (1979). See Rev. Rul. 59-278, 1959-2 C.B. 174; Rev. Rul. 79-388, 1979-2 C.B. 270. Given the timing of the amendments and the words used in their legislative histories, the only thing "clearly demonstrated" by those amendments is that Congress was aware of, and largely disapproved of, the IRS policy on taxation of pensions and annuities.

CONCLUSION

For the reasons set forth in the petition and herein, the writ of certiorari should be allowed.

Respectfully submitted,

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